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STATE FOR NEA/ELA, NEA/RA AND EEB/IDF  
USAID FOR ANE/MEA MCLOUD AND DUNN  
TREASURY FOR MATHIASON AND CONNOLLY  
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SUBJECT: RISING ANXIETY ABOUT PRICE INCREASES: Part II

REF: A. Cairo 0150 B. 07 Cairo 3021 C. 07 Cairo 3097

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Summary  
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**¶11.** (U) Rising food prices have led to demonstrations and pessimism among the poor, but official data show inflation within a reasonable range, given current economic growth. Most analysts believe the official figures do not capture the full picture, particularly as the poor are hurt most by rising food prices, as they spend more of their income on food. The Central Bank kept interest rates unchanged at its last Monetary Policy Committee meeting, but the GOE is taking some measures to control prices. The Ministry of Trade and Industry announced export fees on rice, and the Ministry of Social Solidarity continues to declare its intention to reform the corrupt bread subsidy system. On a trip to local markets in poor neighborhoods, we found buyers able to afford less food than normal, and voicing concerns about feeding their families. The real problems seem to be wages not keeping pace with rising prices and the still-high unemployment/underemployment rate. These problems exacerbate the difficulties of the 45% of Egyptians - some 36 million people - living on less than \$2 dollars per day.

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GOE Maintains Inflation Under Control  
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**¶12.** (U) In contrast to the views of angry demonstrators protesting price increases (Ref A), GOE officials maintain that Egypt's inflation rate is within an acceptable range, given the current 6.9% level of economic growth. The official government inflation rate was 6.87% year-on-year (y-o-y) in November 2007, and 6.94% y-o-y in December, well below the peak of 13% y-o-y in March 2007. Food inflation was 8.5% y-o-y in November and 8.6% y-o-y in December, well below the peak of 16.4% y-o-y in September 2007, when Ramadan began (Ref B). Central Bank officials maintain that inflationary pressure does not warrant a hike in interest rates. At its Monetary Policy Committee meeting in December 2007, the Central Bank kept rates unchanged at 8.75% (deposit) and 10.75% (lending), where they have been since December 2006. In public and private meetings, GOE economic officials assert that maintaining economic growth is more important than controlling inflation. An increase in interest rates would slow growth at a crucial moment, just as the economy is starting to create jobs, according to officials.

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Some Measures to Control Prices  
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**¶13.** (U) Most analysts believe the official data do not capture the

whole picture, and certainly do not capture the higher burden of rising prices on the poor, who spend more of their income on food. In response to rising prices, the GOE has taken some measures to control prices of the most basic commodities, though the measures often have unintended consequences. For example, in early January the Ministry of Trade and Industry announced that it would impose export fees on rice to increase the domestic supply. The Rice Exporters Association voluntarily suspended rice exports starting January 19, when prices of rice reached LE 4 (\$.75) per kilo, about 30% higher than the same time last year. In a public statement, the Association said it hoped that suspending rice exports would lead traders to release more rice into the domestic market, easing prices or at least stopping the increase. While this step may keep more rice in domestic circulation, it has negative consequences for producers trying to sell their product overseas.

**¶4.** (U) Minister of Social Solidarity Ali Al Moselhi has made several public statements indicating an intention to reform the corrupt bread subsidy system. Subsidized bread, which costs 5 piastres (\$.01)/piece at official bakeries, is the mainstay of the diet of poor Egyptians, and therefore the most sensitive commodity. Recent press reports have described long lines subsidized bread at public bakeries, with many would-be buyers turned away when the bread runs out. Buyers are then forced to purchase bread at private bakeries where the prices average five times more at 25 piastres (\$.05) per loaf.

**¶5.** (SBU) In December 2007, the USAID Mission Director and Deputy Director met with Moselhi, who described multiple "mafia-like" operations embedded in every level of the subsidized bread market. Currently public bakeries buy flour from the GOE at subsidized rates of LE 90 (\$16) per 100 kilo sack. These bakeries are supposed to use the flour to make low-cost bread. But as the worldwide increase in wheat prices has hit Egypt, a black market for flour has developed. Public bakeries can sell the same size sack of subsidized flour for up to LE 210 (\$38) on the black market. Al Moselhi painted a very grim picture of the social controls and intimidation that make reforming this corrupt system difficult. He has not given details of how he intends to address the problem, but on a broader level, the GOE has publicly discussed replacing in-kind subsidies with a monetary transfer based on need. In doing so, the GOE is trying to eliminate the price distorting effects and resulting parallel market created by its current subsidy system.

**¶6.** (U) On a trip to a market in one of Cairo's poorest neighborhoods, one group of women described how sacks of flour are sold at public bakeries "right in front of our eyes." The bakers then claim that they have run out of flour and can not produce more low-cost bread. Most public bakeries run out of bread and close for the day within one hour of opening in the morning, according to the women. A baker at a private bakery told us that business is booming, as customers who would have bought bread at public bakeries are now coming to his. He admitted to buying flour from black marketers, claiming that they are often the only suppliers. Since his costs have increased, he's begun making smaller pieces of bread, to avoid raising prices higher than buyers can afford.

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More at the Local Markets  
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**¶7.** (U) We were also told by buyers at the local market that high prices are forcing them to purchase smaller quantities of basic commodities. One woman said she would normally buy one kilo of potatoes for LE 2.50 (\$.46), but now she can only afford one half kilo, as prices have doubled to LE 3.20 (\$.59) per kilo. A meat vendor told us that he has to charge LE 18 (\$3.33) for one kilo of meat, up from LE 15 (\$2.77) one week ago, because of rising transportation costs for the cattle ranchers bring the animals to market. The butcher said his customers have begun purchasing less meat than normal, about two-thirds less in most cases. One woman selling rice, pasta and beans said that her sales have been way down, and she fears she will have to close her stall soon, as it will no longer be profitable.

**¶8.** (U) At a wholesale market outside of Cairo, wholesalers told us that supplies of fruit and vegetables are down, as many farmers are selling their crops to exporters. Rising world prices make

exporting more lucrative than selling domestically. Another group of wholesalers told us that farmers were also charging higher prices than normal, claiming that fertilizer prices had gone up. A black market has emerged for fertilizer, according to the wholesalers, with farmers buying fertilizer from agricultural cooperatives for LE 30 (\$5.55) per 100 kilo bag and selling the same size bag at LE 200 (\$37). Eggplant sellers claimed business has slowed dramatically. Eggplant is a staple of the Egyptian diet, but requires oil for cooking. Edible oil prices have gone up 50% in the past two weeks, from LE 3.50 (\$.64) per liter to LE 7.75 (\$1.43).

¶9. (U) One woman who buys fruits and vegetables at the wholesale market and then sells them on the street in Cairo told us that she has not been able to afford buying wholesale for the last two weeks.

When wholesale prices first began to rise, she purchased at the higher price, but could not sell her purchases on the street. Buyers accused her of greed, saying she was charging higher prices simply to make more money, not to cover increased costs. So she stopped buying, but still goes to the wholesale market daily, hoping prices will come down. Making a gesture showing a noose around her neck, the woman said that people are slowly dying, and they don't know how to feed their families, or what the future will bring.

¶10. (U) All of the people we talked to believed that it was the government's responsibility to control prices. Though many of the vendors in the markets were illiterate, most were familiar with the GOE's privatization program, and claimed that the sale of public companies was just another way for the rich to get richer. One vendor also mentioned the ongoing cement collusion case (Ref C), claiming that collusion among suppliers was the main cause of high prices, as suppliers were speculating by withholding supplies in anticipation of increased prices. Although many believe that the government should do something about prices, none believed that it would. They were uniformly pessimistic about the future, worrying that they would soon not be able to feed their families.

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Comment  
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¶11. (SBU) The government's claim that inflation is within a reasonable range does not take into consideration the real cause of Egyptian woes: wages not keeping pace with prices and high unemployment and underemployment. While there is some anecdotal evidence of higher wages in the booming construction sector, a recent World Bank report indicated that 45% of Egypt's population subsists on less than \$2 per day. Egypt's economic growth has still not produced the number of new jobs needed to bring down unemployment, which officially stands at 9%. While the 9% figure is down somewhat from 10.5% in 2004, most analysts believe it is underestimated.

¶12. (SBU) As noted in Ref A, the GOE will no doubt continue its public campaign to convince Egyptians that it is focused on "social justice" and ameliorating poverty. While the GOE has talked about reforming and retargeting the food subsidy program, little progress has been made, and the discussion has largely served to confuse and further worry Egypt's poor. In addressing the real problem of creating pro-poor growth and jobs for the middle and lower classes, GOE plans lack any specificity at all. The GOE may face more demonstrations over high prices if it cannot demonstrate some quick wins.

JONES